

Chapter 4

Criticisms

1.1 Some witnesses expressed concern about possible unintended consequences of ABIP. These include impact on competition within the commercial finance sector, the lending criteria that will be used by ABIP to assess commercial viability, the breadth of arrangements that ABIP could enter into and the perceived disproportionate risk being borne by the taxpayer. There was also concern about the level of parliamentary scrutiny of ABIP's operations.

Encouraging foreign bank withdrawal

1.2 One argument made against ABIP is that it may encourage foreign banks to withdraw because it will allow them to repatriate without the risk of losing money from Australian assets in which they have an interest. This was described by the Property Council as being regarded as the strongest argument against ABIP.¹

1.3 This criticism appears to assume that ABIP would be stepping in to finance property assets at their full (original) price, rather than the current market price, and so foreign banks would have nothing to lose from selling on or choosing not to continue to finance an asset. The implication is that, if ABIP was not willing to finance an asset, that lender would realise a loss by leaving, which might persuade them to stay.

1.4 However, it has been made clear that ABIP would be lending based on contemporary market values not original values:

From the very first announcement by the government, it was clear that, to the extent that there would be any rollover finance extended to an individual project, it would be on its revalued price, and all decisions had to be unanimous. The banks are not noted for lending money on the basis of projects which are overvalued.²

1.5 This criticism of ABIP was also firmly rejected by Treasury:

...my very strong view is that this in fact will assist to keep foreign banks here, not the opposite...³

1.6 Their reasoning was as follows:

1 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, p 12.

2 Mr Peter Verwer, CEO, Property Council of Australia, *Proof Committee Hansard*, 14 April 2009, p 9.

3 Mr Richard Murray, Executive Director, Treasury, *Proof Committee Hansard*, 14 April 2009, p 81.

ABIP is there in terms of its lender of last recourse to underpin some stability in the market...lending by ABIP will be more expensive than the market, it does give an incentive for the borrower to say, 'We do have this backstop but we can't be guaranteed by the backstop. We are already facing repricing, so the loans from the syndicates are becoming more expensive as they are rolled over. Therefore we would rather keep the syndicate together rather than being an easy exit arrangement for the foreign borrower.'...ABIP is not going to be, as Mr Ergas suggested, bailing out distressed assets; far from it. It will be concentrating on financially viable assets and they are the sort of assets you would have thought the foreign banks would want to stay in rather than bail out of.⁴

1.7 Mr Fahour, in challenging the criticism, was able to draw on his personal experience as a foreign banker:

I think the existence of these contingency plans supports our financial system. Having in my past life once worked for a foreign bank as its chief executive in Australia, I can give you some of my experiences. When a foreign bank operates in our country, one of the reasons why they are here and want to stay here is the stability and liquidity that this country provides in doing transactions. So, firstly, anything that we do to support stability and liquidity actually encourages in the long term participants to operate in the marketplace. Secondly, one of the issues [with that idea]... is that any one loan would precipitate a complete withdrawal of a foreign bank...typically, a foreign bank will not leave a country just because one loan is up and they think: 'We can get this refinanced with ABIP, so let's pack our bags and go.' Typically, what you would find is most of the loans are a fraction of their total portfolio. Therefore, whether they leave Australia or not is a much bigger decision taken in foreign lands.⁵

Committee view

1.8 The committee regards the risk of ABIP encouraging foreign bank withdrawal as small and not warranting opposition to the bill.

Lending criteria

1.9 The precise lending criteria which ABIP will use to assess applications for funding are yet to be determined. Mr Ahmed Fahour, interim CEO of ABIP, has indicated that lending criteria will be developed which reflects the objective of ABIP being a low-risk lender to commercially viable projects. He said:

We have the privilege in ABIP of being able to work with all of the big four banks and get the best of their risk management systems, knowledge and information on how to set up the lending criteria in such a way that, as soon

4 Mr Richard Murray, Executive Director, Treasury, *Proof Committee Hansard*, 14 April 2009, p 81.

5 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, pp 41-42.

as the legislation is passed and the doors are open, we are in a position to prudently lend to investment grade projects that are commercially viable. Of course, the commercial lending criteria of any sensible bank will take into consideration factors such as repayment ability, interest coverage ratios and loan to value ratios. We would also take into consideration the fact that property prices have fallen recently and therefore we would want an up-to-date market valuation because our job is not to artificially hold up prices; our job is to make sure that we lend prudently.⁶

1.10 According to the Government, the lending criteria will be 'appropriate, prudent, and broadly consistent with the lending criteria of the four major banks. They will be determined unanimously by all five shareholders.'⁷ Properties located outside Australia, land banks, speculative development assets and rural property will fall outside the scope of ABIP's lending criteria.

1.11 Further, to protect the interests of ABIP shareholders, any major domestic bank that is an existing participant in a financing arrangement before ABIP, must maintain at least their existing level of financing in percentage terms. This will provide a safeguard to ensure that ABIP only lends on fully commercial terms.

1.12 This also ensures that, when ABIP lends to an organisation that does not meet all the lending criteria (which can only be done on unanimous agreement of all shareholders) the shareholders are all bearing further risk as a result. Mr Fahour explains:

Let us pretend for a minute that the loan to value ratio that we will accept is 50 per cent and something comes along with 55 per cent [but] it meets a whole bunch of other criteria—it has really high cashflow coverage, it has a valuation that was done yesterday, it meets every other criteria and, on balance, it is commercially viable and investment grade. You want to have the flexibility for the board to say, 'This is commercially viable but it didn't meet that criterion over there.' ...the board may not reject it on the basis that it fulfils the objectives overall.⁸

1.13 Mr Fahour sought to clear up some misapprehensions about the nature of ABIP's lending:

ABIP is not a bad bank. It is not a US TARP. It is not a bail-out fund. It is not there to clean up the mess of bad lending. It is not there to do any of those things. It is purely a contingency company to prevent market failure if it were to occur and to support financially viable firms, not bad banks, not bad assets, not toxic assets—none of those.⁹

6 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 36.

7 The Hon Lindsay Tanner MP, *House of Representatives Hansard*, 12 March 2009, p 2502.

8 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 45.

9 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 40.

1.14 Mr Fahour has indicated that the shareholders are currently developing the precise lending criteria and that the details may be available before the passage of the bill.

1.15 Dr Henry Ergas has challenged the assertion that ABIP's lending criteria will be consistent with the lending criteria of the four major banks. He says:

If consistent with means "similar to", and ABIP's lending criteria are in this sense consistent with the criteria of the four major banks, it is unclear why ABIP's lending decisions would be any different from the decisions that the banks would take in the absence of ABIP. In turn, if ABIP's decisions are based on the same criteria as the decisions that would be taken by market participants, how is ABIP "correcting" a market failure? If lending will only occur under these circumstances, why would ABIP be required?¹⁰

Committee view

1.16 The committee is of the view that *in a normally functioning market*, it is likely that Australian banks would be in a position to invest in a commercially viable project when a foreign bank withdraws. However, ABIP, as a contingency fund and a lender of last recourse, is designed to finance commercially viable projects when this normal function of the market fails.

Conflict of interest issues

1.17 Some concern has been raised over whether conflict of interest issues exist when one (or more) of the four major banks form part of a syndicate with a foreign bank. If the market is functioning well and the foreign bank withdraws from the syndicate, another lender would usually take up the stake. If no other such bank was willing, the asset would be sold off and the value of the asset written down. If this scenario happened to an asset that met ABIP's lending criteria, it would be in the interest of any of the major bank(s) involved in the syndicate for ABIP to take up the stake to prevent the fire sale, thus 'holding up' the asset value.

1.18 As discussed above, this argument would have force were ABIP buying at prior 'book values', but ABIP will be buying at market values.

1.19 When asked whether a member of ABIP would benefit if they were part of a syndicate, a foreign bank pulled out and ABIP stepped in, Mr Fahour explained:

... not only can they not have their own loans refinanced; they cannot reduce their size and position in that syndicate. [That said,] there are some secondary benefits.¹¹

1.20 He indicated that he felt that these secondary benefits were appropriate given the \$2 billion that the major banks contributed to the initiative in the first place.

10 Concept Economics, *Submission 10a*, p 2.

11 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 48 .

Competition issues

1.21 Mr Ergas regarded the information exchange between banks involved in their participation in ABIP as potentially anti-competitive. However, he conceded banks participating in syndicated loans are also sharing information about borrowers.¹²

1.22 Section 16 of the ABIP bill specifically renders the activities undertaken by ABIP, its shareholders, directors, officers, agents and employees in furtherance of ABIP's objectives exempt from the competition provisions of the *Trade Practices Act* (TPA).¹³

1.23 When asked whether the ACCC felt this exemption was warranted, ACCC Chief Executive Officer, Mr Brian Cassidy pointed to the potential that, in the absence of the exemption, the joint venture defences may be available to ABIP but that without further details such a hypothetical analysis would be impossible.¹⁴

1.24 Mr Cassidy pointed out that such legislative exemptions in Commonwealth legislation were unusual (but by no means unknown) and that no specific advice to the Treasury was sought or given regarding the particular implications of the inclusion of the clause, nor whether or not ABIP would potentially be involved in anti-competitive behaviour. Mr Cassidy said:

To be quite honest, the first we knew of the existence of section 16 in the bill was when we saw the bill, and that was when it was tabled. We did have some indication from Treasury, when we were talking to them about the requests from the committee for us to table emails, that they were giving serious consideration to the possibility of having a section 51 exemption, but the first we knew concretely that there was going to be an exemption was when we saw it in the bill.¹⁵

1.25 When asked if the exemption from TPA competition provisions may allow behaviour even beyond cartel-like behaviour, Mr Cassidy said:

The way proposed section 16 is drafted, it does not specifically refer to just section 45 [of the TPA], which deals with anti-competitive agreements; it refers to the competition provisions in the Trade Practices Act more generally. So, in the sense that it provides a shelter for conduct from the competition provisions, it is not only anticompetitive agreements but it could be conduct under section 46, abuse of market power. Indeed, the way it is drawn, it could be any of the competition provisions.¹⁶

1.26 As the ACCC does not monitor Section 51 exemptions (such as that contained in Section 16) despite their obvious position as the best-placed expert in competition matters, these exemptions are ultimately the responsibility of the government to

12 Mr Henry Ergas, Concept Economics, *Proof Committee Hansard*, 14 April 2009, p 66.

13 Treasury, *Submission 9*, p 21.

14 Mr Brian Cassidy, CEO, ACCC, *Proof Committee Hansard*, 14 April 2009, p 54.

15 Mr Brian Cassidy, CEO, ACCC, *Proof Committee Hansard*, 14 April 2009, p 55.

16 Mr Brian Cassidy, CEO, ACCC, *Proof Committee Hansard*, 14 April 2009, p 56.

monitor. When a state government grants a section 51 exemption, the Australian government has the power to override such an exemption, which is usually exercised on the advice of the National Competition Council.

1.27 Without the Section 16 exemption, ABIP would be forced to go through the time-consuming process of applying for authorisation from the ACCC to protect it against action under the TPA for anti-competitive behaviour. If the clause was not included, the authorisation process would be the only formal way that ABIP could be protected from action against it for anti-competitive behaviour.

1.28 When questioned about Treasury's view of these criticisms, Mr Richard Murray, Treasury Executive Director said:

I do not believe it is a cartel arrangement—far from it. I listened to Henry Ergas [chairman of Concept Economics], and he made the point that there would be access to certain information, but under the shareholders' agreement there are confidentiality arrangements around that because this is an important issue. Certainly this is not intended as a cartel arrangement; it is intended as a lender of last recourse arrangement and as very much a short-term arrangement. You certainly would not want to override the competition principles governing the banking sector through an arrangement like ABIP, and we have tried to put in place safeguards against that.¹⁷

Committee view

The committee is satisfied that there are valid reasons, not least providing certainty about its operations, to exempt ABIP from the *Trade Practices Act*.

Broad scope

1.29 While the Prime Minister's announcement of the scheme only referred to lending for commercial property,¹⁸ there is no restriction in the bill. Section 7(2) says:

A further object of ABIP Limited is to provide financing in other areas of commercial lending...

1.30 Mr Fahour said:

The second part of the criticism is that this should not be allowed to go beyond commercial real estate. It is not for me to make that judgment. Right now we are focused on commercial real estate, but it does have the ability, with all five shareholders, to allow it to go beyond commercial real estate. And it is up to you good folks to decide whether that should be allowed or not.¹⁹

1.31 This scope has been criticised in some submissions:

17 Mr Richard Murray, Treasury, *Proof Committee Hansard*, 14 April 2009, p 81.

18 Prime Minister, *Media Release*, 24 January 2009.

19 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 48.

The broadening of the scope has an adverse effect of the Australian market by actively discouraging regional banks that are not part of the ABIP, foreign financial service providers and possible new entrants from competing in the Australian market.²⁰

1.32 Any such commercial lending would still require the unanimous support of the ABIP board.

Committee view

1.33 The committee acknowledges that concerns have been expressed regarding the ability of ABIP to make loans outside of the commercial property sector. However in view of the fact that:

- i) ABIP is a temporary measure only able to make loans for two years from its establishment specifically due to the withdrawal of foreign investment and
- ii) The Government chairs the board and unanimous support is required regarding the viability of a project in order for ABIP to make loans

the committee is satisfied that sufficient protections exist to prevent loans being abused and that in limited circumstances ABIP may wish to consider projects outside of the commercial property sector.

Parliamentary scrutiny

1.34 There has also been criticisms that the bill does not provide for sufficient parliamentary scrutiny of the governance structures, lending criteria and other rules governing ABIP.

1.35 Mr Fahour sought to ease these concerns, pointing out that the rules governing ABIP:

...will be put through and they will have the enforceability of the Corporations Law. There will be directors. It is very unusual in the sense of a corporation to have rules in place that require a unanimous decision by all shareholders before one thing can be changed. That puts an enormous onus on anybody trying to change anything. I can assure you that trying to get four banks, four risk officers, and the chairman who is representing the Commonwealth and the taxpayer all to agree is not going to be easy. It is not going to be easy to get some of these loans through or some of these changes made. I worked for one company, and trying to get it to do something was hard enough with one board, let alone four.²¹

20 GE Capital Finance Australasia, *Submission 2*, p 2.

21 Mr Ahmed Fahour, *Proof Committee Hansard*, 14 April 2009, p 39.

Committee view

1.36 The committee is of the view that the prudential standards of ABIP will be sufficiently stringent, the requirement for unanimity in decision making will be effective, and the requirement for the four major banks to maintain their exposure in assets that ABIP lends to provide an effective framework to mitigating risk to the taxpayer. Combined with the chairperson's effective 'veto' of decisions, the requirement that the directors provide the Minister a copy of ABIP's financial report, directors' report and auditor's report (prepared by the Auditor-General) to be tabled in both houses of Parliament and the publishing of lending criteria and the Shareholders Agreement, the committee is of the view that the measures taken to help mitigate risk and provide sufficient parliamentary scrutiny of ABIP's operations are sufficient.